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Tidewater Telecom

Service Quality

Report Period: Quarter 4 of 2011

For a description of each of the service quality measures see [glossary](#).

Performance Area	Oct	Nov	Dec	Current Quarter	Prior Quarter	2nd Quarter Prior	3rd Quarter Prior	Rolling Average
Number of Network Trouble Reports (Res and Bus)	7	7	8	22	27	32	17	24.5
Number of Lines	9623	9548	9492	28663	29388	29387	29581	29254.75
Network Trouble Report Rate per 100 Lines	0.07	0.07	0.08	0.07	0.09	0.10	0.05	0.07
Total Troubles not cleared within 24 hours (Res and Bus)	0	0	0	0	0	0	0	0
Total Number of Troubles	33	20	20	73	105	128	61	91.75
Percentage of Total Troubles not cleared within 24 hours	0%	0%	0%	0%	0%	0%	0%	0%
Total Install appts. not met comp reasons (Res and Bus)	0	0	0	0	0	0	0	0
Total Install Appointments	41	39	25	105	155	171	87	129.5
Percentage of Total Install appts. not met comp reasons	0%	0%	0%	0%	0%	0%	0%	0%
Total Number of Delay Days	0	0	0	0	0	0	0	0
Total Number of Missed Appts.	0	0	0	0	0	0	0	0
Average Number of Delay Days	-	-	-	-	-	-	-	-
Major Service Outage	0	0	0	0	0	0	0	Rolling Total: 0

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TIDEWATER TELECOM, INC.

FINANCIAL STATEMENTS

December 31, 2011

With Independent Auditors' Report



INDEPENDENT AUDITORS' REPORT

The Board of Directors
Tidewater Telecom, Inc.

We have audited the accompanying balance sheet of Tidewater Telecom, Inc. as of December 31, 2011, and the related statements of income and accumulated deficit, and cash flows for the year then ended. These financial statements are the responsibility of Tidewater Telecom, Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Tidewater Telecom, Inc. as of December 31, 2011, and the results of its operations and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

Berry Dunn McNeil & Parker, LLC

Portland, Maine
March 15, 2012



TIDEWATER TELECOM, INC.

Balance Sheet

December 31, 2011

ASSETS

Current assets

Cash and cash equivalents	\$ 847,021
Accounts receivable, net of allowance for doubtful accounts of approximately \$17,000	819,176
Materials and supplies	637,022
Prepaid expenses and other current assets	4,079
Due from related parties	<u>1,361,393</u>

Total current assets	<u>3,668,691</u>
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Property, plant and equipment, at cost

Land and buildings	6,390,039
Central office equipment	16,336,760
Cable and wire facilities	27,761,377
Other equipment	1,644,387
Telecommunications plant under construction	<u>55,672</u>

	52,188,235
Less accumulated depreciation	<u>31,222,060</u>

Net property, plant and equipment	<u>20,966,175</u>
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Noncurrent assets

Investments in nontraded stocks	170,715
Intangible, net	<u>8,359,983</u>

Total noncurrent assets	<u>8,530,698</u>
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	<u>\$ 33,165,564</u>
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The accompanying notes are an integral part of these financial statements.

LIABILITIES AND STOCKHOLDER'S EQUITY

Current liabilities	
Accounts payable	\$ 87,267
Accrued expenses and other current liabilities	<u>222,655</u>
Total current liabilities	309,922
Deferred income taxes	<u>9,681,900</u>
Total liabilities	<u>9,991,822</u>
Commitments and contingencies (Notes 6 and 7)	
Stockholder's equity	
Common stock, no par value; 10,000 shares authorized; 1,853 shares issued and outstanding	-
Paid-in capital	24,824,759
Accumulated deficit	<u>(1,651,017)</u>
Total stockholder's equity	<u>23,173,742</u>
	<u>\$ 33,165,564</u>

TIDEWATER TELECOM, INC.

Statement of Income and Accumulated Deficit

Year Ended December 31, 2011

Operating revenues	
Basic local network services	\$ 2,875,629
Network access services	3,644,819
Miscellaneous	313,582
Uncollectible revenues, net of recoveries	<u>(23,535)</u>
Total operating revenues	<u>6,810,495</u>
Operating expenses	
Plant specific operations	1,189,403
Plant nonspecific operations	830,028
Depreciation and amortization	2,289,827
Customer operations	739,972
Corporate operations	<u>1,463,905</u>
Total operating expenses	<u>6,513,135</u>
Operating taxes	
Federal and state income taxes	13,200
Other operating taxes	<u>264,598</u>
Total operating taxes	<u>277,798</u>
Net operating income	<u>19,562</u>
Other income (expense)	
Interest and dividends	16,257
Other, net	650
Income taxes	<u>(7,000)</u>
Net other income	<u>9,907</u>
Net income	29,469
Accumulated deficit, beginning of year	(174,653)
Less dividends	<u>(1,505,833)</u>
Accumulated deficit, end of year	<u>\$ (1,651,017)</u>

The accompanying notes are an integral part of these financial statements.

TIDEWATER TELECOM, INC.

Statement of Cash Flows

Year Ended December 31, 2011

Cash flows from operating activities	
Net income	\$ 29,469
Adjustments to reconcile net income to net cash provided by operating activities	
Depreciation and amortization	2,289,827
Deferred income taxes	(513,000)
Accretion of patronage capital certificates	(6,828)
Decrease (increase) in	
Accounts receivable	36,442
Materials and supplies	(2,263)
Due from affiliates	65,722
Prepaid expenses and other current assets	(3,239)
Decrease in	
Accounts payable	(1,639)
Accrued expenses and other current liabilities	<u>31,469</u>
Net cash provided by operating activities	<u>1,925,960</u>
Cash flows from investing activities	
Extension and replacement of telecommunications plant	<u>(395,732)</u>
Net cash used by investing activities	<u>(395,732)</u>
Cash flows from financing activities	
Payment of dividends	<u>(1,505,833)</u>
Net cash used by financing activities	<u>(1,505,833)</u>
Net increase in cash and cash equivalents	24,395
Cash and cash equivalents, beginning of year	<u>822,626</u>
Cash and cash equivalents, end of year	<u>\$ 847,021</u>

The accompanying notes are an integral part of these financial statements.

TIDEWATER TELECOM, INC.

Notes to Financial Statements

December 31, 2011

Nature of Operations

Tidewater Telecom, Inc. (the Company) derives its operating revenues primarily from providing telecommunications and broadband services in Maine. The Company extends credit at standard terms, after appropriate review, to its subscribers and domestic interexchange carriers. Telecommunications services are subject to varying degrees of regulation by the Federal Communications Commission (FCC) and the Maine Public Utilities Commission (MPUC).

1. Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Regulatory Accounting

The Company is subject to regulation of rates and other matters by the FCC and the MPUC. The Company follows the accounting prescribed by the Uniform System of Accounts of the FCC and the MPUC and Financial Accounting Standards Board Accounting Standards Codification (ASC) 980, *Regulated Operations*. This accounting recognizes the economic effects of rate regulation by recording costs and a return on investment, as such amounts are recovered through rates authorized by regulatory authorities. The Company annually reviews the continued applicability of ASC 980 based on the current regulatory and competitive environment.

Cash and Cash Equivalents

All liquid investments with an original maturity of three months or less are considered to be cash equivalents. The Company maintains its cash in bank accounts which may exceed federally insured limits; however, the Company's policy is to invest cash in excess of those limits in government-backed securities or accounts collateralized by bank-owned U.S. government securities or surety bonds. The Company has not experienced any losses in such accounts, and believes it is not exposed to any significant risk with respect to these accounts.

Accounts Receivable

Accounts receivable are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable.

TIDEWATER TELECOM, INC.

Notes to Financial Statements

December 31, 2011

Materials and Supplies

Materials and supplies are valued at the lower of first-in, first-out (FIFO) cost or market.

Depreciation

Depreciation is computed on average plant investment by primary plant accounts using the straight-line method over the estimated useful lives of the assets. The Company assesses the estimated remaining useful lives of assets on an annual basis.

Capitalization Policy

Additions to plant and replacements of retirement units of property are capitalized at original cost, which includes labor, material and overhead, and direct charges such as equipment costs.

Investments in Nontraded Stocks

The Company owns Rural Telephone Finance Cooperative (RTFC) Patronage Capital Certificates (PCCs) that are recorded at their present value. The Company is accreting the PCCs to face value over a period of ten to twenty-five years, based on the expected repayment dates. These PCCs are included in investments in nontraded stocks in the balance sheet and the annual accretion is included in interest and dividend income in the statement of income.

Intangible Asset Subject to Amortization

The intangible asset subject to amortization consists of a franchise license which is being amortized by the straight-line method over the asset's estimated useful life of thirty years.

Sales Taxes

The Company reports sales taxes on a net basis; accordingly, they are recorded as a liability when collected from customers and excluded from revenues and expenses.

Income Taxes

Deferred income taxes are provided for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes.

The Company files a consolidated tax return with its Parent. Income taxes are allocated to the Company based on the statutory rates of the consolidated group applied to its separate income before income taxes.

As of December 31, 2011, tax years 2008 through 2010 remain subject to examination by federal and state authorities.

TIDEWATER TELECOM, INC.

Notes to Financial Statements

December 31, 2011

Revenue Recognition

Operating revenues are recognized when services are provided to customers.

Interstate network access revenues are based on estimates of the telephone plant investment, operating expenses, and allowable rates of return on investments allocable to those services. Nationwide pooling of the revenues is administered by National Exchange Carrier Association (NECA), of which the Company is a member. NECA files interstate access charge tariff schedules with the FCC and accumulates and distributes pooled revenues, derived from interstate access services, to its members. The Company records the effect of NECA settlements, including retroactive adjustments, if applicable, upon notification of such settlements from NECA.

Intrastate network access service revenues result from charges to interexchange carriers based on applying intrastate access tariffed rates to intrastate access usage.

Subsequent Events

For purposes of preparation of these financial statements in conformity with U.S. generally accepted accounting principles, the Company has considered transactions or events occurring through March 15, 2012, which was the date the financial statements were available to be issued.

2. Telecommunications Plant Adjustment

A telecommunications plant adjustment of \$17,332,256, net of accumulated amortization of \$3,303,538 at December 31, 2011, which is included in property, plant and equipment in the balance sheet, is a regulatory adjustment representing the difference between the fair value of the property, plant and equipment acquired and the original cost of the plant, less the associated depreciation. The Company is amortizing the adjustment over a period of seven to thirty years which approximates the estimated remaining useful lives of the underlying assets. Amortization expense included in depreciation and amortization expense in the statement of income was \$978,828 in 2011. This amortization is not recoverable through rates, as mandated by a stipulated agreement with the MPUC.

3. Investment in Nontraded Stocks

Investment in nontraded stocks consists of RTFC PCCs. The noncash PCCs accrete on an annual basis and will be redeemed at their face value through 2035. Total accretion in 2011 was \$6,828. Total PCCs received through December 31, 2011 amounted to a face value of \$312,806 and recorded present value of \$170,715.

TIDEWATER TELECOM, INC.

Notes to Financial Statements

December 31, 2011

4. Intangible Asset Subject to Amortization

The intangible asset consists of a franchise license of \$9,419,705, net of accumulated amortization of \$1,059,722 at December 31, 2011. Amortization expense approximated \$314,000 in 2011. Estimated amortization expense through 2016 is as follows:

2012	\$ 314,000
2013	314,000
2014	314,000
2015	314,000
2016	314,000

5. Income Taxes

The actual tax expense differs from that computed at a federal rate of 34% primarily because of state income taxes.

The components of income tax expense (benefit) at December 31 are as follows:

	<u>Current</u>	<u>Deferred</u>	<u>Total</u>
Federal income tax	\$ 398,200	\$ (382,900)	\$ 15,300
State income tax	<u>135,000</u>	<u>(130,100)</u>	<u>4,900</u>
	<u>\$ 533,200</u>	<u>\$ (513,000)</u>	<u>\$ 20,200</u>

Amounts payable to the parent for current income taxes are included in due from related parties at December 31, 2011.

The income tax expense is allocated for the years ended December 31 as follows:

Operating income	\$ 13,200
Other income	<u>7,000</u>
	<u>\$ 20,200</u>

The components of the deferred tax liability (asset) at December 31 are as follows:

Temporary differences related to:	
Depreciation and amortization	\$ 9,762,000
Other	<u>(80,100)</u>
	<u>\$ 9,681,900</u>

TIDEWATER TELECOM, INC.

Notes to Financial Statements

December 31, 2011

6. Regulatory Matters

State Matter

In 2007, CRC Communications of Maine, Inc. (CRC) and Time Warner Cable Information Services (Maine), LLC (TWCIS) petitioned the MPUC to lift the rural exemption and grant authority for them to provide local exchange service in the territories currently served by the Company. In order to grant such authority, the MPUC would have to determine doing so was: i) not unduly economically burdensome on the incumbent local exchange carrier impacted by the exemption, ii) technically feasible, and iii) consistent with the universal service provisions of the Telecommunications Act of 1996 (the Telecom Act). In late 2008, the MPUC ruled CRC and TWCIS had not provided sufficient evidence to substantiate their requests and dismissed them; however, the MPUC allowed CRC and TWCIS the option to file renewed petitions provided they present detailed analyses on the negative economic impact on the Company. CRC filed a renewed petition in early 2009. In June 2010, the MPUC ruled the impact of lifting the rural exemption and permitting TWCIS and CRC to provide local exchange service in the Company's territories would be unduly economically burdensome and denied CRC's petition. In July 2010, TWCIS filed a petition with the FCC to overturn the MPUC ruling. At present, the case remains ongoing before the FCC and the future impacts, if any, on the regulated operations, revenues and expenses of the Company is unknown at this time. The Company received requests to negotiate interconnection agreements from CRC and TWCIS in June 2011 and September 2011, respectively. In August 2011, the Company filed a petition with the MPUC under Section 251(f)(2) of the Telecom Act to request suspension of its obligation to negotiate. In February 2012, CRC filed a petition for arbitration with the MPUC. At present, the MPUC has not ruled on the Company's Section 251(f)(2) petition or CRC's petition for arbitration and the future impacts, if any, on the regulated operations, revenues and expenses of the Company are unknown at this time.

Federal Matter

In October 2011, the FCC issued an Order reforming Intercarrier Compensation and Universal Service Fund (USF) mechanisms and announced the issuance of a Further Notice of Proposed Rulemaking (FNPRM) on long-term USF reform and transition timing. The Order and FNPRM introduce limitations on capital expenditures and operating expenses recoverable from the USF, and significantly reduce carrier access rates over an extended transition period. Management is monitoring the impact of the reform, but the current Order does not appear to have a significant impact on intrastate and interstate network access services revenues in the near term. This evaluation is subject to change as the FNPRM has not been finalized, and the Order is being challenged in court.

TIDEWATER TELECOM, INC.

Notes to Financial Statements

December 31, 2011

7. Related Parties

The Company provides to and receives from related parties through common ownership various network, management, and operation services under an intercompany management services agreement, which has been approved by the MPUC. Charges between these related parties in 2011 approximated:

Provided to:

Coastal Telco Services, Inc.	\$ 726,000
Lincolnvile Communications, Inc.	299,000

Received from:

Coastal Telco Services, Inc.	\$ 3,679,000
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The Company's, Lincolnvile Telephone Company's (Parent) and its subsidiaries' assets are collateral in a loan agreement entered into by the Parent. The loan is due in quarterly installments through June 30, 2018, when the balance is due in full. The Parent's outstanding balance on the loan was \$21,200,000 at December 31, 2011. The Company does not presently expect to be required to perform on its obligations under the loan agreement.

